Before The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992	)	CS Docket No. 98-82
	)	
Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996	)	CS Docket No. 96-85
	)	
The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules	)	MM Docket No. 92-264
	)	
Review of the Commission's Regulations Governing Attribution Of Broadcast and Cable/MDS Interests	)	MM Docket No. 94-150
	)	
Review of the Commission's Regulations and Policies Affecting Investment In the Broadcast Industry	)	MM Docket No. 92-51
	)	
Reexamination of the Commission's Cross-Interest Policy	)	MM Docket No. 87-154

SUPPLEMENTAL COMMENTS OF AT&T CORP.

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SUPPLEMENTAL COMMENTS OF AT&T

Pursuant to the Commission's June 3, 2002 Public Notice ("*Supplemental Notice*") in the above-captioned proceeding, AT&T Corp. ("AT&T") respectfully submits these supplemental comments regarding Office of Plans and Policy Working Paper No. 35, "Horizontal Concentration in the Cable Television Industry: An Experimental Analysis" by Mark Bykowski, Anthony M. Kwasnica and William Sharkey ("*Working Paper*").

INTRODUCTION AND SUMMARY

Video programming is *the* critical input to any successful cable television operation. Consumers have countless entertainment alternatives, including the competing offerings of direct broadcast satellite ("DBS") providers that distribute the same video programming and that have

the ability to serve virtually all cable subscribers. In this dynamic environment, no cable operator, regardless of its size, can afford to ignore consumers' video programming preferences. Cable operators devote enormous resources to identifying and obtaining rights to distribute the video programming that consumers demand, and carriage negotiations are among the most sophisticated commercial negotiations, in part because the importance of video programming to cable operators is not lost on the owners of that programming.

The Commission has amassed a wealth of economic and empirical evidence in this remand proceeding that overwhelmingly demonstrates that, given these marketplace realities, even a cable operator much larger than any that exists today would not have the incentive and ability to exercise market power in its dealings with suppliers of video programming. The Commission should base its assessment of speech-restricting limits on cable ownership concentration on this record and these marketplace realities. *See Time Warner Entertainment Co.* v. *FCC*, 240 F.3d 1126 (D.C. Cir. 2001) ("*Time Warner II*").

The *Notice* asks whether a laboratory game from which the authors of the *Working Paper* report a number of results should inform the Commission's ownership limit determinations. In one respect, the game results are of limited interest in adding to the already vast record evidence that additional cable consolidation would not impede the competitive flow of video programming to consumers. Despite failing to take account of many of the most important marketplace characteristics that constrain cable, the *Working Paper* found no material difference in cable operator "bargaining power" in games that purported to model market structures in which the largest cable operator served from less than 30 percent to more than 50 percent of subscribers.

The *Working Paper* also reports, however, that "efficiency" and DBS "bargaining power" declined with increased concentration in some game scenarios. The *Working Paper* does not

explain how these experimental results are relevant to the Commission's inquiry into the existence of the "real" and "non-conjectural" risk of buyer market power abuse that *Time Warner II* makes clear is a condition precedent to any sustainable limit on cable ownership concentration. As explained below, they are not.

First, as experimental economist Andrew Schotter explains in the declaration that accompanies these supplemental comments, "[i]n designing an experiment to comment on a real-world phenomenon, it is a strict requirement that the experiment present the subjects with the tradeoffs that real-world agents face when they make their decisions, and that the variables of concern to subjects in the lab be the same variables that real-world decision-makers care about." July 18, 2002 Declaration of Andrew Schotter ¶ 4 ("*Schotter Declaration*"). The laboratory experiment described in the *Working Paper* does not meet that requirement.

Real-world carriage negotiators are highly sophisticated and knowledgable repeat players. In any carriage negotiation, each side knows much about the other side's alternatives, costs and revenue opportunities. Real-world negotiators are highly-trained professionals that meet face to face in drawn out negotiations that routinely take months, sometimes last years, and culminate in complex long-term contracts worth many millions, or even billions, of dollars. In the *Working Paper* experiment, in contrast, the student players had *six minutes* to negotiate multiple "contracts," had almost no information about each other and were playing for only a few dollars. The players were not even told what they were buying and selling, and they were not allowed to communicate except through the computer transmission of numerical offers and acceptances. The *Working Paper* may provide useful information regarding how economic actors negotiate when they have "little information, no opportunity to communicate, and limited

time in which to make multiple deals," but "it sheds no light on the real-world efficiency of negotiations between MVPDs and programmers." *Id*. ¶ 7.

Perhaps most importantly for present purposes, real-world buyers and sellers recognize the dynamic consequences to a cable operator – in subscribers lost to DBS and other competitors – of failing to obtain rights to distribute desirable programming. In the laboratory experiment, in contrast, "cable" players that failed to strike bargains suffered no such dynamic market penalties; rather, each player's size stayed constant from one trading period to the next in each scenario, regardless of its own or others' "programming" decisions. In this respect, the *Working Paper* suffers from the same fatal defect *Time Warner II* found in the Commission's "open field" approach to ownership limits – its failure to reflect the reality that "a company's ability to exercise market power depends not only on its share of the market, but also on the elasticities of supply and demand, which in turn are determined by the *availability* of competition." *Time Warner II*, 240 F.3d at 1134. Thus, any attempt to set ownership limits on the basis of the *Working Paper*'s efficiency or DBS findings would be doomed to reversal under a straightforward application of *Time Warner II*. *Id.* ("in revisiting the horizontal rules the Commission will have to take account of the impact of DBS on th[e] market power of [cable operators]").

But even if the experiment had been designed to capture the key real-world variables and had been carried out in a manner that could reasonably be said to replicate real-world negotiations, the efficiency and DBS results could not support ownership limits. The *Working Paper* (at 49) reports a "modest" reduction in "efficiency" between the game's highest concentration scenario and lower concentration scenarios. But this "efficiency" reduction – more precisely, the fact that some transactions that would have benefitted both the buyer and

seller were not consummated in some of the game sessions – cannot be explained by any theory of buyer market power, because "the students acting as buyers did not even know their relative sizes. If some were more aggressive, it was because of their personalities, not the market structure." *Schotter Declaration* at ¶ 58.

In any event, the average efficiency level of the highest concentration scenario was seriously distorted by the performance of students in just *one* outlier session. *Id*. ¶ 53. Indeed, a detailed examination of the outlier trading session shows that the anomalous results were primarily due to the failure of *one seller to reach agreement with one buyer in one 6-minute bargaining period*. If this outlier is disregarded, the average efficiency for the highest concentration scenario is exactly the same as that reported for the next highest concentration scenario, which the authors of the *Working Paper* concede is not significantly different from the efficiency observed in the *lowest* concentration scenario. For these and other reasons detailed below, the *Working Paper*'s efficiency results are of no possible value here.

The Working Paper's "DBS" conclusions are no more robust or relevant. Indeed, the conclusion that in one scenario, "the DBS operator's bargaining power is higher in the Low/High concentration sessions than in the High/Low concentration sessions," *Working Paper* at 34, reflects the observation of just *five* students in each of those two "treaments." Moreover, the two "DBS" players who were the *most* successful were, in fact, in the High/Low concentration sessions; it was only because the two least successful "DBS" players were also in that group that the *average* bargaining power was lower in the High/Low sessions. *Schotter Declaration* at ¶ 62. "Given these disparate results, it seems untenable to argue that the increased concentration in the High/Low structure *causes* DBS operators to have less bargaining power." *Id*.

More fundamentally, the *Working Paper* provides no basis for characterizing one player as a DBS operator and the others as cable operators. The game's "buyers" were told only their uncovered "fixed costs" and the "resale value" of each of the unidentified "fictitious" assets they could purchase. The costs and resale values assigned to the "DBS" player differed from those assigned to the "cable" players, but the *Working Paper* does not explain the derivation of these figures, much less demonstrate that they are representative of real-world differences between cable and DBS. In any event, the "DBS" player actually earned *more* profits, on average, than the "cable" player with an equal number of customers. "It is hard to see why any public policy issue is raised if DBS operators have less bargaining power but nevertheless earn higher profits than cable companies." *Id*. at ¶ 68.

In short, the *Working Paper* may be a useful contribution to the emerging field of laboratory study of bargaining under incomplete information, but it has no buyer market power predictive value and provides no non-conjectural basis for any cable ownership limit.

ARGUMENT

I. THE LABORATORY EXPERIMENT REPORTED IN THE *WORKING PAPER* IGNORED KEY REAL-WORLD CONSTRAINTS.

Experimental economics examines economic interactions "in controlled laboratory settings." *Notice* at 1. By observing students playing bargaining and other games, experimental economists seek to test and refine economic theories. That approach has proven useful in studying certain real-world institutions, such as auctions, where it is possible to create laboratory environments that are close fascimiles of real-world environments. However, "[e]xperiments are usually *not* suited to address empirical issues about the underlying structure of industrial markets." John H. Hagel & Alvin E. Roth, *ed.*, *Handbook of Experimental Economics* at 355 (1995) (emphasis added).

And although bargaining behavior is a frequent subject of laboratory experiments, leading experimental economists urge "healthy skepticism" with respect to claims that "the phenomena observed in the laboratory are likely to generalize to the wider world." *Id.* at 329. That is because the environments explored in the laboratory are necessarily "quite simple and artificial" while "bargaining outside of the laboratory virtually always takes place in more complex environments." *Id.*[1] "Consequently, some of the phenomena that appear important in the laboratory may have much diminished importance in naturally occurring negotiations, and phenomena that have no opportunity to emerge in the laboratory may assume much more importance." *Id*.

The predictive value of experimental economics is at its nadir where, as here, bargaining under incomplete information is modeled. The "emerging experimental study of bargaining under incomplete information" is "especially difficult" and "especially susceptible to controversy," because so much depends upon the players' subjective beliefs, which are "essentially unobservable parameters." *Id*. at 322.

Even where experiments can play a useful predictive role, they can only do so if the laboratory environment mirrors the real-world environment. As Dr. Schotter explains, "it is a strict requirement that the experiment present the subjects with the tradeoffs that real-world agents face when they make their decisions, and that the variables of concern to subjects in the lab be the same variables that real-world decision-makers care about." *Schotter Declaration* at ¶ 4. Attention to the experimental procedures – *e.g.*, the instructions given to players and the incentives they have as well as time and other constraints – is also important. "[E]xperiments are

[1] *See also* Working Paper at 3 ("the experimental market did not and could not display all the complex characteristics of the actual market").

very sensitive to these elements; a small change in procedures, information or incentives can lead to a substantial change in the outcome." *Id*.

Measured against these criteria, it is clear that the laboratory results described in the *Working Paper* could not serve as the basis for structural regulation in this proceeding. According to the *Working Paper* (at 18), the laboratory experiments involved a trading institution described as a "decentralized bargaining market (DBM)." "[T]his particular institution has never before been studied in experimental economics, and so we have no knowledge about how other subjects have responded to it and no basis for evaluating whether the [*Working Paper*] subjects performed in a typical manner." *Schotter Declaration* at ¶ 6. *See also Handbook of Experimental Economics* at 425 ("It is especially risky to claim that a single experiment confirms a general theory or establishes a stylized fact").

The subjects of the *Working Paper* experiment are "given almost no information before they begin and virtually no feedback as the session progresses; hence they are in no position to assess their bargaining strength." *Schotter Declaration* at ¶ 7. The experiment thus involves precisely the type of bargaining under incomplete information from which experienced experimental economists are especially reluctant to draw generalized conclusions. And, as detailed below, the experiment procedures (particularly the very short time limits) and the erratic behavior of a few players appear to have seriously distorted the experimental results.

Most fundamentally, the laboratory environment bears no resemblance to the real-world. The experiment was "a time-constrained matching market played under conditions of incomplete information about the market parameters, in which all subjects have fixed costs that must be covered by profitable trades in order to avoid losses." *Id*. at ¶ 6. Players were told only that they were buying and selling unidentified "fictitious" assets. *See Working Paper* at 72. The players

assigned buyer roles had no information about their relative sizes, *Schotter Declaration* at ¶ 16, and no information (other than an assigned "resale value") about the sellers' products, costs, revenue opportunities or bargaining histories. No face-to-face negotiations were allowed; indeed, no communications of any kind were allowed, except for the computer transmission of offers and acceptances. *Id*. ¶ 7.[2] Buyers in the game could not gain or lose market share, and, as noted, no buyer even knew how large it was compared to other buyers. Similarly, the sellers were given no information that would allow them to guage the relative values of their products. *Id*. ¶ 18. "A player's only concern is with making correct matches or enough of them – not the player's current or future share of the market." *Id*. ¶ 8.

Moreover, the players received almost no feedback from one round to the next. "They have no way of knowing whether the deals they made were good or bad" or "whether others have traded or not." *Id*. ¶ 39. It is well recognized in experimental economics that the "absence of information and feedback can lead to what is known as a 'self-fulfilling equilibria' in which subjects quickly develop a set of erroneous views about what trades are possible." *Id*. "Believing that they cannot do better, the subjects make offers that are accepted and never explore other possibilities." *Id*.

The real-world is, of course, very different. Professional, real-world negotiators have a great deal of highly relevant information, communication and feedback. Sellers of video programming know each buyer's market share and channel line-up, and, presumably, will also know the popularity of their own programming. Sellers will generally also know what each

[2] *See also Handbook of Experimental Economics* at 295 ("a careful comparison of face-to-face and anonymous bargaining . . . . found that face-to-face bargaining captured over 99 percent of the gains from trade in an environment in which anonymous bargaining captured only 92 percent").

buyer has been willing to pay in the past for comparable programming, what programming each buyer has recently added and dropped, and the general rate of inflation in buyers' programming costs. Sellers most definitely know that all buyers face retail competition and that this competition provides powerful incentives for buyers to purchase desirable, competitively-priced video programming, because the failure to do so will result in lost share.

In the real-world, buyers and sellers can and do communicate, often face-to-face. A seller, for example, can say to a potential cable buyer "my network is being carried by Echostar; do you want to risk losing customers by not carrying it?" And in the real-world there is near constant feedback – buyers and sellers can see which deals are made and which networks are carried on which systems. *Id*. ¶ 40.

In addition, virtually none of the variables that are most important to real-world programming buyers were reflected in the bargaining game. One particularly "important element of the marketplace that was not reflected in the experiment is the competition between DBS and cable operators for the same subscribers – a rivalry that would tend to diminish the bargaining power of both when negotiating with programmers (because one would be at a competitive disadvantage if it failed to carry programming offered by the other)." *Id*. ¶ 85. The experiment likewise failed to reflect the real-world fact that carriage contracts are multi-year contracts and that expected profits to the seller turn not on the buyer's existing share of subscribers, but on the buyer's expected number of subscribers over the life of the multi-year contract (which turns, in part, on other buyers' programming decisions). The experiment ignores both the existence of "must-see" networks that suppliers of video programming can and do bundle with less desirable channels and the marketplace reality that owners of video programming can obtain cable carriage even without the cable operator's consent by contracting

with these "must see" networks or "must carry" broadcast networks. The experiment did not account for the real-world constraint that any buyer that is large enough to be "pivotal" to the seller's decision whether or not to produce desirable programming cannot credibly threaten to refuse to pay its "share" of the production costs. Although the experiment provided for additional payments to sellers meant to represent advertising revenues, it did not reflect the many other revenue opportunities available to owners of video programming, including revenues from foreign distribution. And the experiment modelled only very highly concentrated market structures with only three to five buyers and "HHI" concentration levels more than twice existing levels. Thus, although experimental economists warn that it is always dangerous to generalize from the results of laboratory bargaining under imperfect information, it would plainly be irrational to do so here.

It would also be unlawful. If nothing else, *Time Warner II* makes clear that any "assessment of a real risk of anticompetitive behavior" in this context must take account of the "availability" of cable alternatives and the extent to which that competition constrains cable market power. *Time Warner II*, 240 F.3d at 1134 ("in revisiting the horizontal rules the Commission will have to take account of the impact of DBS on th[e] market power of [cable operators]"). As the original public notice in this remand proceeding explained, it can no longer be doubted that "the availability of an alternative MVPD outlet affords programmers access and consumers choice, and erodes cable's or an MSO's market power irrespective of current market shares."[3] *See also Schotter Declaration* at ¶ 8 ("the experiment would have to be dynamic and one in which market concentration was an endogenous variable"). Bcause the experiments

[3] *Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992, et al.*, Further Notice of Proposed Rulemaking, 16 FCC Rcd. 17312 ¶ 50 (2001).

described in the *Working Paper* did not "take account" of this key factor (or many of the other market-specific variables that constrain real-world video programming carriage negotiations), the Commission could not, consistent with *Time Warner II*, impose horizontal ownership limits on the basis of the experimental results.

II. THE *WORKING PAPER*'S "EFFICIENCY" AND "DBS" RESULTS ARE OF NO VALUE IN THIS PROCEEDING.

Even if it was appropriate to generalize from the results of laboratory bargaining under imperfect information (it is not) and even if these particular experiments had been designed and implemented to mirror real-world carriage negotiations (they were not), the *Working Paper*'s "efficiency" and "DBS" results could not be credited. As explained below, neither of those experimental results is reliable or says anything at all about the risk of buyer market power in real-world video programming carriage decisions.

A. The Working Paper's "Efficiency" Results.

The experiment yielded only one efficiency result that the *Working Paper* regards as statistically significant. This "modest reduction in 'economic efficiency'" involved the scenario in which cable capacity was limited and carriage contracts did not contain "most favored nations" provisions (as they often do in the real-world). Three scenarios were modelled, a "High/High" structure in which the largest of five buyers had a 51% "market share," a "Low/High" structure in which the largest of five buyers had a 27% share, and a very highly concentrated "High/Low" structure in which there are just *three* buyers with shares of 44%, 39% and 17%. In each scenario, one of the buyers (the one with the 17% share) was deemed the DBS operator; all other buyers were deemed cable operators. Notably, the *Working Paper* found *no* statistically significant difference in efficiency when the four cable buyers in the Low/High

structure "merged" into just two cable buyers with shares of 44% and 39% in the highly concentrated High/Low structure.

Rather, the only difference deemed statistically significant was between the Low/High structure in which the largest cable operator had a 27% share and the High/High structure in which the largest cable operator had more than a 50% share – and even that difference could be deemed significant only under a very undemanding test of statistical significance, *see Schotter Declaration* ¶ 55. For a number of reasons, "[n]o policy conclusions should be drawn from th[is] result[]." *Id*. ¶ 34.

First, a reduction in "efficiency" as defined in the *Working Paper* principally reflects a failure to reach agreements that would be mutually profitable to buyer and seller. The *Working Paper* offers no economic theory why there would be a link between an increase in buyer concentration and the failure to enter into contracts that would be profitable for *both* parties. Certainly, these results cannot be explained by any theory of buyer market power, the relevant consideration in this proceeding. The *Working Paper* "found that the larger buyers did *not* have greater bargaining power or negotiate better terms." *Schotter Declaration* ¶ 58. "Indeed, the students acting as buyers did not even know their relative sizes." *Id*. Thus, "[i]f some were more aggressive" and that aggressiveness resulted in more bargaining failures, "it was because of their personalities, not the market structure." *Id*. Moreover, the bargaining failures that drove the results claimed to be statistically significant were not the product of decisions by the players acting as the largest cable company, but failures of the players acting as the three *smallest* cable companies. *Id*. ¶ 59. "[W]here (as here) an experiment produces results that are not predicted by theory, further study may be warranted – but policy conclusions are not." *Id*. ¶ 60.

Second, the students playing the experimental games *regularly* failed to reach agreements that would have been mutually profitable. As Dr. Schotter explains, the efficiency levels observed in the *Working Paper* games, "with an average of only 87.21 percent," are "quite low compared to the levels observed in other experiments designed to replicate matching markets." *Schotter Declaration* at ¶ 35; *see also id.* ("what is most striking about the experimental results is that the subjects were inefficient bargainers *regardless* of market concentration"). The experimental results are also flatly inconsistent with real-world observations. In the real-world the most popular programming networks *always* get carriage, but in the experiment, the student acting as the most popular programming network frequently failed to reach agreements with the students acting as cable buyers. *Id*. Indeed, as explained below, the failure in one of the trading sessions of the most popular network to reach a mutually profitable deal largely accounts for the efficiency difference the *Working Paper* deems statistically significant.

This pronounced disparity between both conduct in the real-world and prior experimental economics experience is further reason to review the experimental results with great skepticism. "[T]here is some underlying cause of the bargaining failures in the experiment that is not found in the actual marketplace," and, as Dr. Schotter explains, that cause is most likely the design flaws identified above. *Id*. In the actual marketplace, commercial actors have information and experience, can communicate, and constantly receive feedback. In the experiment, subjects had little information and no experience, could not communicate, and received no relevant feedback – in short, "the experiment deprived the subjects of the elements needed to bargain efficiently." *Id*. ¶ 41. Morevoer, Dr. Schotter's examination of the trading data suggests that the need to cover fixed costs and the very short time limits for negotiation produced behavior that "is more consistent with *loss avoidance* than with *profit maximization*." *Id*. ¶ 48. "In the real-world,

MVPD operators and programmers face no comparable time limit, and they undoubtedly behave in a manner consistent with profit maximization." *Id*. ¶ 50.

Finally, even if the market institution in the experiment did resemble the actual marketplace, "the efficiency results are not sufficiently robust to even consider drawing any conclusions for policy-making purposes." *Id*. ¶ 52. Very little data – only four experimental sessions, each involving only five student "buyers" – were used to measure "economic efficiency" in the "High/High" scenario. *Id*. And the average efficiency level observed in that scenario – the figure that served as the basis for the *Working Paper*'s efficiency finding – "was seriously distorted by the poor performance of the students in just *one* session." *Id*.

The results of sessions 1, 2 and 4 of the High/High scenario match up relatively closely to each other and to the efficiency results measured in the other scenarios. Indeed, the average efficiency from those three sessions was the *same* as the average efficiency measured for the High/Low scenario. As the *Working Paper* found, the High/Low scenario average efficiency was not significantly different from the Low/High average efficiency. In other words, if the *Working Paper* had properly disregarded the outlier session 3 in the High/High scenario, it would have found *no* significant difference in efficiency results between *any* of the scenarios.

And High/High session 3, with an average efficiency of only 67.6%, clearly was an outlier. "[A] detailed examination of the outlier trading session shows that the anomalous results were primarily due to the failure of *one seller to reach agreement with one buyer in one 6-minute bargaining period*." *Schotter Declaration* ¶ 54. That seller, # 4, was the one designated as the most popular/valuable programming network, and because he was by far the "biggest" seller, that failure had a very large impact on the efficiency level for the session as a whole. "If Seller #4 had reached a deal with Buyer #7 in Period #8 (a result they had achieved in previous

rounds), then the efficiency level for this session would have been 16% higher (*i.e.,* an 84% average), and there would no longer have been a statistically significant difference in efficiency levels related to buyer concentration." *Id*. "Obviously, it would be foolish to reach any policy conclusions because of the results of the negotiation between Seller #4 and Buyer #7 in Period #8." *Id*.[4]

Moreover, the second lowest average involving the High/High scenario (83.3% in session # 4) was also distorted by one particular 6-minute trading round that produced an efficiency of only 37.7% (from students that performed quite well in the other 6-minute trading rounds in that session). *Id*. ¶ 56. If that one 6-minute trading period were disregarded, the average economic efficiency for session # 4 would have been 98.9%, not 83.3%. *Id*. "And if that result were used, then the High/High structure would actually have produced the *most* efficient average outcome, not the least efficient." *Id*. For these and other reasons explained in the *Schotter Declaration*, the *Working Paper*'s efficiency results are entitled to no weight in this proceeding.

B. The *Working Paper*'s "DBS" Results.

The *Working Paper*'s "DBS" results are equally irrelevant here. The experiments in the *Working Paper* yielded a variety of seemingly conflicting results regarding the buyer that was supposed to represent a DBS operator. In the "MFN" scenario (in which the largest cable operator could impose a most-favored-nations requirement), the "DBS" player's bargaining power was higher in the more concentrated High/Low scenario than in the less concentrated Low/High scenario, but when the largest cable operator could not impose an MFN, the DBS

[4] It is widely recognized that experimental economics is ill suited to explain why mutually beneficial transactions do not take place. *See Handbook of Experimental Economics* at 321 ("there remains considerable room for improvement in our understanding of the causes of disagreement and delay").

player's bargaining power was *lower* in the more concentrated High/Low. *Schotter Declaration* ¶ 61. The *Working Paper* has no rational explanation for this disparity and none is apparent.

None of the DBS results are robust. Indeed, the conclusion that "the DBS operator's bargaining power is higher in the Low/High concentration sessions than in the High/Low concentration sessions," *Working Paper* at 34, reflects the observation of just *five* students in each of those two "treaments." Moreover, the two "DBS" players who were the *most* successful bargainers were, in fact, in the High/Low concentration sessions. The *average* bargaining power was nonetheless lower in the High/Low scenario, because the two least successful "DBS" players were also in that group. *Schotter Declaration* at ¶ 62. "Given these disparate results, it seems untenable to argue that the increased concentration in the High/Low structure *causes* DBS operators to have less bargaining power." *Id*. "It is far more likely that the results reflect the bargaining skills of the particular individuals participating in the experiment." *Id*.

In any event, the *Working Paper* provides no basis for characterizing one player as a DBS operator and the others as cable operators. The game's "buyers" were told only their "fixed costs" and the "resale value" of each of the unidentified "fictitious assets" they could purchase. The costs and resale values assigned to the "DBS" player differed from those assigned to the "cable" players, but the *Working Paper* does not explain the derivation of these figures, much less demonstrate that they are representative of real-world differences between cable and DBS. For example, buyers 7 and 9 in the Low/High scenario had the same number of customers. Buyer 7 was told that he needed to cover $434 in uncovered fixed costs; Buyer 9 was told that he needed to cover $339. *Id*. ¶ 63. It seems highly unlikely that the authors of the Working Paper had any reliable information "about the relative level of uncovered costs for cable and DBS operators; they certainly have not cited any." *Id*. n. 28. The game also assigned different resale

values to the buyers 7 and 9, notwithstanding that they were buying the same programming and offering it to the same customer base. Again, the Working Paper does not even attempt to justify these figures "by showing that they correspond to the relative revenue streams available to DBS and cable operators." *Id*. ¶ 65.

But even if these seemingly arbitrary uncovered cost and resale values did reflect real-world differences between cable and DBS operators, examination of the trading data confirms that "these factors were swamped by the influence of the personalities of the few subjects in the experiment who played these roles." *Id*. ¶ 66. The five students who played buyer 7 ("cable") earned profits ranging from $499 to $1209. *Id*. ¶ 67. The five students who played buyer 9 ("DBS") earned profits ranging from $316 to $1305. *Id*. "These variations should give one pause before attempting to draw any conclusions from a few data points about the bargaining power of 'DBS operators' versus 'cable operators.'" *Id*. "The outcomes would certainly seem to be influenced much more heavily by the bargaining capabilities of the individual students than by the parameters that distinguish 'DBS' from 'cable' operators." *Id*.

In any event, the "DBS" player actually earned *more* profits, on average, than the "cable" player with an equal number of customers. "It is hard to see why any public policy issue is raised if DBS operators have less bargaining power but nevertheless earn higher profits than cable companies." *Id*. at ¶ 68.

III. NOTWITHSTANDING THE FAILURE TO REFLECT KEY MARKET-SPECIFIC FACTORS THAT CONSTRAIN BARGAINING POWER, THE *WORKING PAPER* FOUND NO CORRELATION BETWEEN "BARGAINING POWER" AND CABLE OPERATOR SIZE ACROSS THE MARKET STRUCTURES THAT WERE MODELLED.

The most interesting aspect of the *Working Paper* is the cable bargaining power results. Unlike the efficiency findings, which, as discussed above, were based primarily on bargaining *failures* likely caused by problems with the experimental design (*e.g.*, severe limits on

information, communications, feedback and time), these bargaining power results relate only to bargaining *successes* (*e.g.*, contracts actually negotiated by the game players). The problems of generalizing from laboratory bargaining under imperfect information are therefore less pronounced with respect to the bargaining power results (although still quite substantial). Moroever, the sellers in the game did have information about the relative size of the the buyers and thus this aspect of the experiment "was designed so that (1) sellers can make more money from dealing with buyers having larger shares, (2) sellers know how important it is to enter into a contract with the largest buyer, and (3) sellers are better able to say 'no' to the biggest buyer (and still make a profit) in less-concentrated markets than in more-concentrated markets." *Schotter Declaration* ¶ 83. The *Working Paper* found that sellers fared equally well against the largest buyer, regardless whether the largest "cable" buyer had a 27% share or a 51% share. That was true notwithstanding that the experimental world, as discussed above, failed to take account of many of the market-specific real-world factors (*e.g.*, the ubiquitous availability of DBS) that contrain buyer power in this particular context.

This is not to suggest, of course, that the *Working Paper*'s bargaining power results should play an important (or even any) role in this proceeding. As noted above, there are many reasons why it would be arbitrary to base industrial policy on the first laboratory experiment of its kind, particularly one that strays so far from real-world conditions. Moreover, the record in this proceeding is replete with evidence that *does* take account of the important market-specific factors and that deals directly with the relevant questions of buyer market power and is therefore considerably more compelling. However, the *Working Paper*'s bargaining power results do give the lie to the arguments of proponents of low cable ownership concentration limits, who argue that it simply cannot be that a cable buyer that serves more than 30 percent of subscribers lacks

market power over suppliers of video programming and that, based upon this "intuition," the Commission must disregard the record evidence and established economic theory.

CONCLUSION

For the foregoing reasons and the reasons set out in AT&T's initial and reply comments in this proceeding, the Commission should conduct this proceeding in accordance with the dynamic market power analysis mandated by *Time Warner II* and the Commission's longstanding policies on the basis of the market-specific evidence already in the record.

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July 18, 2002

CERTIFICATE OF SERVICE

I hereby certify that on this 18th day of July, 2002, I caused true and correct copies of the forgoing Supplemental Comments of AT&T Corp. to be served on all parties by mailing, postage prepaid to their addresses listed on the attached service list.

Dated: July 18, 2002
Washington, D.C.

/s/ Peter M. Andros

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